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IN THE

Supreme Court of the United States

OCTOBER TERM 1962

No. 1000

RICHARD H. SHAFER and MARY ANN SHAFER,
Petitioners,

v.

UNITED STATES OF AMERICA,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

CHARLES P. TAFT,
Counsel for Petitioner,
1003 First National Bank Bldg.,
Cincinnati 2, Ohio,
Tel. 513-241-2383.

THE JOHNSON & HARDIN CO., LAW PRINTERS
CINCINNATI, OHIO

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Petitioners pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Sixth Circuit entered in the above cause on January 11, 1963.

CITATION TO OPINIONS BELOW

The opinion of the District Court printed in Appendix hereto, *infra*, p. 1a, is reported in 204 F. Supp. 473. The memorandum opinion of the Court of Appeals, printed in Appendix hereto, *infra*, p. 7a, is reported in 312 F. 2d 747.

JURISDICTION

The judgment of the Court of Appeals was entered on January 11, 1963 (R. 21). The jurisdiction of this Court is invoked under 28 U. S. C. Section 1254 (1).

QUESTION PRESENTED

Whether defaulted coupons of defaulted pre-Second World War Japanese bonds, overstamped in 1952 with dates exactly ten years later than original, and required to be separated from the main obligation, and payable irrespective of the later call of the main obligation under a bondholder's settlement with the Japanese government in September 1952, became capital assets whose later sale permitted capital gains treatment of the proceeds.

STATUTES INVOLVED

Internal Revenue Code of 1939, U. S. C. Title 26.

Section 112(a)

Upon the sale or exchange of property the entire amount of the gain or loss, determined under Section 111, shall be recognized except as hereinafter provided in this section.

Section 117(a)(1) Capital Assets.

(As used in this Chapter) The term "capital assets" means property held by the taxpayer (whether or not connected with his trade or business). . . .

For purposes of this chapter. . . .

(4) Long Term Capital Gain. The term "long term capital gain" means gain from the sale or exchange of a capital asset held for more than eighteen months, if and to the extent such gain is taken into account in computing net income.

Internal Revenue Code of 1954, U. S. C. Title 26.

Section 1002

Except as otherwise provided in this subtitle, on the sale or exchange of property the entire amount of the

gain or loss, determined under section 1001, shall be recognized.

Section 1221.

For purposes of this subtitle, the terms "capital asset" means property held by the taxpayer (whether or not connected with his trade or business). . . .

Section 1222.

For purposes of this subtitle . . . (3) Long-term capital gain. The term "long-term capital gain" means gain from the sale or exchange of a capital asset held for more than six months, if and to the extent such gain is taken into account in computing gross income.

STATEMENT

The Stipulation of Facts was as follows (R. 15):

"It is hereby stipulated that for the purposes of this action the following statements shall be accepted as the facts of this case, without prejudice to the right of either party to object thereto on the grounds of relevancy or materiality or to introduce other and further evidence not inconsistent therewith:

"1. This Court has jurisdiction of this action under the provisions of Section 1346(a)(1), Title 28, United States Code.

"2. The plaintiffs were, and are now, citizens of the State of Ohio, residing at 6720 Lee Road, Westerville, Ohio, in the County of Franklin, Ohio.

"3. (a) Prior to the year 1941, plaintiffs purchased 6% Oriental Development Company Ltd. bonds due March 15, 1953 in a face amount of $44,000, and 6½% Imperial Japanese Government External Loan Bonds due February 1, 1954 in a face amount of $16,000. Both such bonds had semiannual interest coupons attached.

"(b) Due to the state of war existing between the United States of America and the Japanese Government,

service on these bonds was suspended on December 8, 1941. On December 11, 1941, the Securities and Exchange Commission advised stock and bond exchanges and dealers throughout the United States to cease handling all transactions in Japanese bonds, which included those set out above held by the plaintiffs.

"(c) By release No. 4518, dated November 11, 1950, the Securities and Exchange Commission removed the restrictions on trading Japanese Bonds. On December 22, 1952 the Japanese Government resumed service on the bonds to those holders who accepted a proposed settlement whereby the maturity date of the bonds and the payment date of each interest coupon bearing an original payment date prior to September 26, 1952, was extended for a period of 10 years from the original payment date, except that interest due prior to December 1942 was payable on December 22, 1952. The plaintiffs agreed to this settlement proposal with respect to these bonds.

"(d) The New York Stock Exchange then ruled that blocks of coupons (originally consisting of 20 coupons for the period 1942 to 1952, but under the terms of the offer, due from 1952 to 1962) could be detached from the bonds and sold in transactions apart from the purchase and sale of the bonds themselves.

"4. In the year 1954 plaintiffs sold coupons on these bonds bearing thereon restamped due dates subsequent to 1954 through Bache & Co., a member of the New York Stock Exchange, in the open market to unknown purchasers, receiving therefor $18,336. In addition, plaintiffs received interest of $8,677.44 on the current (due in 1954) coupons on these bonds.

"5. On their timely filed joint 1954 federal income tax returns, plaintiffs reported as long term capital gain an amount of $18,336 for 'Coupons past due Gov't bonds,' and reported ordinary interest income in the amount of

$8,157.44 for 'Oriental and Japanese Bonds—Current,' and in the further amount of $520.00 for 'Bache & Co.—Interest Japanese Bonds.'

"6. This 1954 return was audited by agents of the Commissioner of Internal Revenue, and a deficiency in tax was determined based upon the Commissioner's determination that the amount of $18,336 received from Bache & Co. for the sale of the block of post-1954 coupons (referred to in paragraph 4 above) was ordinary income rather than long-term capital gain as reported, as well as certain other adjustments to income not here in issue. The deficiency so determined in the amount of $14,126.50, plus interest of $2,999.07, or a total of $17,125.57, was timely assessed, and satisfied by plaintiffs by payments in the amount of $14,126.50 on October 29, 1958, and $2,999.07 on November 18, 1958.

"7. On September 2, 1959, plaintiffs timely filed a claim for refund in the amount of $12,101.76, on the ground that the amount of $18,336 received for the sale of the block of post-1954 coupons, as set out above, qualified for long-term capital gain treatment. By registered notice dated April 25, 1960, the Commissioner rejected this claim, and this suit for refund was timely commenced.

"8. If the Court should decide that this amount of $18,336 qualified for long-term capital gain treatment, there will be a joint computation by the parties of the appropriate refund amount, with submission to the Court if there should be a dispute as to this amount."

In addition to the agreed Statement of Facts, the Court will find in Revenue Ruling 54 in 1953-1 Cum. Bulletin p. 204, referred to by the District Judge in his opinion, a paragraph which discusses these bonds. The paragraph quoted in that opinion, CB 1953-1, p. 205, is as follows:

> "For the extended periods after original maturity dates, the bonds shall bear interest at the same rate

and with the same semi-annual payment dates of each extended year as specified in the original contracts and or indentures. The Japanese Government will endeavor to arrange that, about 1 month prior to the first semi-annual interest payment date in the first such extended year, or as soon as possible in the case of bonds already matured, new coupon sheets corresponding to such extended periods shall be attached to the respective bonds. In case where new coupon sheets are not ready by the date of actual payment, scrip or other certificates may be delivered so as to serve the purpose of the interest payment."

The next relevant paragraph therein, CB 1953-1, pp. 205-206, is as follows:

"The coupons bearing payment dates prior to December 22, 1942, shall be payable on December 22, 1952. The payment dates of the coupons bearing payment dates on or after December 22, 1942, and prior to September 26, 1952, shall be extended in each case for the exact period of ten years, and payment shall be made on the new dates. *Coupons overprinted with new payment dates shall be detached from the bonds* so that such bonds may be transferred or delivered separate and apart from such coupons, scrip, or other certificates so overprinted with new payment dates. *Such coupons, scrip, or other certificates, so overprinted with new payment dates shall continue to be payable on the new payment dates overprinted thereon, notwithstanding the prior maturity, or redemption of the bonds to which they originally appertained, and the accrued interest represented thereby will not be deemed to be 'accrued interest' for the purpose of determining the redemption price of bonds or the maximum price at which bonds may be purchased with moneys in a sinking fund therefor.*" (Emphasis by Counsel.)

It will also be noted in this last quotation that the bonds were callable.

REASONS FOR GRANTING THE WRIT

The nub of the opinion of the District Court was that,

"The interest coupons in question represented rights to interest income which they [Petitioners] had purchased in that form. This is not a situation where the plaintiffs made their original investment in detached interest coupons. . . ." (*Infra*, p. 5a.)

". . . Was there an exchange of a capital asset? No. Was there an extension of time for payment? Yes. The sole effect of the offer of settlement of the Japanese Government was a ten-year extension of the maturity or due dates of the bonds or coupons and the terms of the obligation were not otherwise altered." (*Infra*, p. 6a.)

This was held therefore not to be a sale or exchange upon which gain or loss must be recognized.

But the District Court made one serious error, which was not identified by the Court of Appeals. Both Courts (and counsel below, too) failed to note that while the settlement agreement of 1952 did not alter the terms of the original loan as to the bonds themselves except to extend the time, *it did alter the terms as to the coupons.*

The coupons and the bonds are separate obligations, as Chief Justice Stone pointed out in *Helvering* v. *Horst* (1940), 311 U. S. 112.

Obviously the original call provision referred to in CB 1953-1, p. 206, provided for the termination of interest on the date for which a bond was called. But in the settlement agreement it was provided that even if the bonds were called in less than 10 years, the extended coupons should each continue in effect to the overstamped date of payment.

It was for *this* reason that the settlement agreement provided that the coupons *must* be detached and dealt in separately. They were no longer subject to being wiped out by a call and redemption of the principal obligation, but

were independent obligations and no longer payable only as part of the main obligation.

Since the District Court did not grasp this point, it completely misinterpreted the action of the New York Stock Exchange. It failed to note that the blocks of coupons *had to be detached* under the settlement agreement. The District Court said:

> "The New York Stock Exchange ruling that blocks of coupons could be detached from the bonds and sold in transactions apart from the purchase and sale of these bonds themselves was for the benefit of bondholders who wished to realize their interest money without further extension of payment dates at a price which provided for the realization of accelerated income. . . . Plaintiffs did not receive new securities and the only act was the overstamping with new dates for payment of the existing bonds or coupons." (*Infra*, p. 5a.)

On the contrary the obligation of the Japanese Government as to the coupons *was* altered. The New York Stock Exchange ruling was *not* "for the benefit of bondholders who wished to realize their interest money," but was a necessary step to carry out the settlement agreement, and was issued because the coupon blocks were a new and different security.

This particular provision was a most important feature of the settlement agreement. The Japanese Government was refusing to pay any of the interest payments between 1942 and 1952. But for any reason, such as an improvement in their credit rating, and consequent reduction at a later date in the interest rates they must pay, it might profit them to call all or a part of these bonds. Then the holders of the coupon blocks might conceivably get back the equivalent of some of the wartime and post-war interest otherwise not payable in the settlement.

This element was clearly something that could make the coupon block worth more than the discounted value of the future income on the bond, and it constituted "a particularly valuable characteristic" of the block of coupons which makes them wholly distinguishable from the right to receive interest on the principal obligation. In fact, any future payments on coupons after the principal obligation had been redeemed, would not be "income" at all on anything, but some kind of a fortuitous bonus, a "sweetener" attached to the settlement of 1952. See the discussion of the "valuable characteristic" in the Court's opinion in *Langston* (1962 C. A. 5), 308 F. 2d 727, 732, and in the dissenting opinion p. 733. These "valuable characteristic" coupons were not acquired as a tax gimmick. The petitioners were straightforward investors all the way through.

This block of coupons then, when overstamped and returned, were property quite distinct from an ordinary block of detached coupons from a good bond, payable in the future and discounted to the present. *Helvering* v. *Horst* (1940), 311 U. S. 112, and see *Helvering* v. *Hort* (1941), 313 U. S. 28.

However illogical the rule may be that distinguishes them, this is not a block of defaulted coupons, bought separately, and when paid, properly deducted from cost as a return on capital. *Langston* (1962, C. A. 5), 308 F. 2d 729; *McDonald* (1954 C. A. 6), 217 F. 2d 475; *Pierce Corp.* (1941 C. A. 5), 120 F. 2d 206.

What were the petitioner' defaulted coupons prior to the September 26, 1952 agreement and petitioners adherence to it? If they had sold the whole collection "flat," bonds and coupons, the purchaser had a capital asset under the cases just cited. If the petitioners had sold them, and repurchased them after a proper interval or purchased other Japanese bonds in a similar amount, the petitioners had a capital asset. Why did not this process by which they

exchanged a block of defaulted coupons, whatever they were, for a new and different security, place them in the position of the owner of a capital asset, just as much as the other process did for Langston?

We submit that it did.

They were therefore entirely justified in returning the entire sale price as a capital gain in the year of sale.

Counsel is quite conscious that the Supreme Court in deciding whether a case is "certworthy," is not called upon to give the defeated party another hearing (*Magnum* v. *Coty* (1923), 262 U. S. 159, 163). We recognize that the Supreme Court is not, and never has been, primarily concerned with the correction of errors in lower Court decisions (Stern & Gressman, *Supreme Court Practise* (3d Ed.) 120).

The matters raised by this petition perhaps could have been effectively raised in a motion for rehearing in the Court of Appeals, but counsel, preparing this petition, was not employed in time for that.

We do submit, however, that the status of these blocks of coupons is a matter of very wide concern in the financial community. The original issues listed in 1953-1 CB 204 totalled over $468,000,000, and those bonds, including its own, whose payment was assumed by the postwar Japanese Government in 1952, totalled $76,460,000. The coupons on these bonds all had to be separated from the bonds themselves and were in fact dealt with as a separate issue. An erroneous legal status of these coupons should not be established merely by a District Court opinion, affirmed in the Court of Appeals; and more especially it should not be given prestige by denial of certiorari.

The Supreme Court may not be *primarily* concerned with the correction of errors in lower Court decisions. But it has some concern even for that, and is surely much concerned that justice be done in a case affecting conceivably more than 75,000 blocks of similar coupons.

CONCLUSION

We, therefore, urge that this petition for a writ of certiorari be granted, and the cause reversed by memorandum opinion for the reasons stated in this petition.

CHARLES P. TAFT,
Counsel for Petitioner,
1003 First National Bank Bldg.,
Cincinnati 2, Ohio,
Tel. 513-241-2383.